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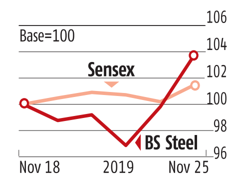
QUICK TAKE: STEEL STOCKS SEE A HOPE RALLY



Steel stocks are up 3–8% in the last one week, much ahead of the 1% rise in the BSE Sensex. Hopes of positive news flow on the US-China trade talks and select price hikes — ₹1,000 a tonne in domestic market — have renewed investor interest in these counters.

"We all know how huge wealth creators like Berkshire, Amazon, and Apple had more than 50% drawdowns multiple times. We think our stocks would be immune to such falls. No stock has divine protection to avoid these"

D MUTHUKRISHNAN,
Certified financial planner

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Foreign investors pour in $6 bn in two months

Flows have accelerated since corporation tax cut, lifting benchmarks by 13%

SAMIE MODAK
Mumbai, 25 November

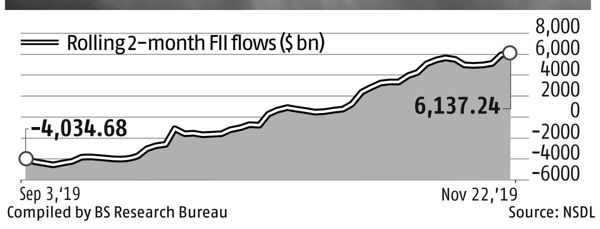
Foreign portfolio investors (FPIs) are pouring money into the domestic market at an unprecedented pace. The net investment by overseas investors into the equities cash segment has topped $6 billion (₹44,000 crore) in the past two months. The rolling two-month FPI flows into the domestic market currently is the highest since May.

The sharp flows have helped the benchmark Sensex and the Nifty surge 13 per cent in just two months.

The earnings-boosting move of lowering corporation tax rates in September, coupled with easing monetary policy globally, are seen as the reasons for sharp inflows into domestic equities.

"The improvement in foreign flows is aided by improving global liquidity," says Vinod Karki, head-strategy, ICICI Securities.

Favourable policy action by two of the world's most influential central banks — the US Federal Reserve and the European Central Bank — has been the trigger for the gush of capital into risk assets, say analysts.



Compiled by BS Research Bureau
Source: NSDL

"The global liquidity is driven by the beginning of QE2 (quantitative easing 2) of $ 22 billion per month by the ECB from November and an increase in the Fed's bond-buying programme to $60 billion a month," says Karki.

In what could be positive news for equity market investors, global economists are forecasting global central banks to continue with their dovish stance into next year.

"While the Fed is now on an extended pause, in our economists' view, we expect global monetary policy to ease further, with the GDP-weighted policy rate marking a trough in March 2020," says a note by Morgan Stanley.

A substantial portion of the $6 billion flows in the past two months have been on account of chunky investments into specific companies that saw large share sales by investors. For instance, a large portion of the $700 million inflow witnessed on Thursday was to buy shares of Zee Entertainment from its promoters. Similarly, share sales in HDFC Life and SBI Life have helped garner large foreign flows.

Thanks to FPI preference for index heavyweights, such as HDFC Bank, HDFC, ICICI Bank, and Reliance Industries, the markets have been able to log new highs. The benchmark Sensex on Monday reached a new all-time closing high ending at 40,889; the Nifty ended at 12,074., just 14 points away from its previous record close made in June.

The benchmark Nifty currently trades at 21.5 times its estimated earnings for 2019-20, two standard deviations above its long-term average.

Some say the market setting has made it difficult for investors as strong overseas flows and reforms expectations are driving up valuations but earning growth continues to deteriorate because of the slowdown in the economy.

"After the recent rally, the risk-reward for Indian equities appears evenly balanced. On the one hand, we expect a further deterioration in the growth environment to hurt corporate earnings, and on the other, equity valuations could remain elevated given risk-on sentiments globally and expectations of further reforms by the government ahead of the Union Budget in early February," says Jitendra Gohil, head of India equity research, Credit Suisse Wealth Management.

Banks may make accelerated provisioning for Karvy Group

DEV CHATTERJEE, ABHIJIT LELE & ANUP ROY
Mumbai, 25 November

Several banks and NBFCs, which have high exposure to Karvy Group entities, have started discussions with their lawyers and the group's officials on how to recover funds from the beleaguered Hyderabad-based financial services provider. Banks are also toying with the idea to make accelerated provisioning for the account — in case, events take a turn for the worse.

The discussions are centered around the collateral kept by Karvy's companies, which have taken close to ₹2,900 crore from several banks, including ICICI Bank, HDFC Bank, and Lakshmi Vilas Bank.

"The talks are on with lawyers to find out the nature and depth of the financial hole in Karvy," said a source close to the development. "We are also finding out from Karvy what steps are it is taking to return our funds," said a banker.

A senior public sector bank executive said lenders are tightening exposure to group entities. Karvy as a registrar and transfer (R&T) agent was doing well, but it went on expanding into many different areas. This has partly contributed to the challenge the group is facing today. Concern over the situation in the real estate business is having a domino effect on the way lenders are looking at the group, he said, adding lenders are yet to meet for discussions on Karvy Group.

A banking source said Karvy has not defaulted as yet and the management has given comfort to banks that the group is adequately funded. But banks are unwilling to take chances and will likely go for accelerated provisioning against the account, on a best practice basis, said a senior banker with a private bank having exposure to Karvy.

IN A BIND

- Karvy's weakening financial profile has been worrying banks
- CRISIL downgraded Karvy Data Management Services' NCDs
- Bank exposure topped ₹2,900 crore to Karvy entities
- Banks have not reported any default by Karvy yet

The banker said a few loans are secured by adequate security and there is no cause for concern on that amount. "In the normal course, we may not have thought of provisioning, but RBI auditors may have a different idea. In case Karvy defaults with one bank, all the banks may have to show it as an NPA according to subjective interpretation. The Basel norms have lots of such subjective interpretations and banks don't take many risks now," said the banker.

Bankers are also worried at the weakening of profile of Karvy on the account of increasing working capital requirements, primarily because of delays in the realisation of receivables and raising funds.

"A delay in realisation of receivables, especially from the Andhra Pradesh government and increase in realisation period from large customers in the subsidiaries' contact centre business, exerts pressure on the group's liquidity," said rating firm CRISIL on Monday.

Last Friday, Securities and Exchange Board of India (Sebi) barred Karvy Stock Broking (KSBL) from taking new clients over the alleged misuse of clients' securities. In an order, Sebi's whole-time member Ananta Barua said there was a "need for urgent regulatory intervention to prevent further misuse of clients' securities". Sebi said prima facie ₹1,096 crore was transferred by KSBL to its group firm Karvy Realty between April 2016 and October 19, 2019.

Further, Sebi said KSBL sold excess securities (securities not available in DP account) to the tune of ₹485 crore through nine related clients until May 31, 2019. Karvy transferred excess securities to six of these nine related clients to the tune of ₹162 crore until May 31, 2019.

On subsequent verification, Sebi found that securities worth ₹257 crore pledged on behalf of four of the nine clients were unpledged during June 1-August 22, 2019 and securities worth of ₹ 217.85 crore were recovered by KSBL from four of these client accounts. KSBL also purchased securities in five such accounts amounting to ₹228.07 crore during June 1- September 8, 2019.

When contacted, an ICICI Bank official spokesperson declined to comment on client-specific queries. The bank has the highest exposure to Karvy Group entities at ₹875 crore; an insider said the exposure is limited to ₹600 crore. Aditya Birla Finance, which has an exposure of ₹109 crore to Karvy, says it has collateral of Karvy's prime property in Hyderabad.

'Owe only ₹40-50 cr to our clients'

SAMIE MODAK
Mumbai, 25 November

Karvy Stock Broking (KSBL) owes ₹40-50 crore to its clients and the money will be repaid over the due course, said a top official. The brokerage refuted claims that it has defaulted on loans worth ₹2,000 crore.

"We don't know from where this ₹2,000 crore figure has come. I would like to say all the securities are intact. All these will be credited into regular accounts. So investors don't have to worry as to what will happen to their securities. There is no default in this particular case. The Sebi order says that the securities have not been dealt with properly," said the official.

On Friday, the Securities and Exchange Board of India (Sebi) passed an ex-parte interim order against KSBL, barring it from taking new clients for the alleged misuse of client funds. The official said some of the client shares were used for proprietary trading. "What we do is we sell on one exchange and buy it on another exchange. It is arbitrage. These are the things which have not been properly understood and we will explained the regulator soon. The number looks large as it is over a period of time. On a daily basis, it is a very small order," the official said, adding that "₹40-50 crore of client money needs to be repaid and this will be done in the normal course." The official said Karvy's clients are worried after the Sebi order and the company is reaching out to them to explain the ground reality.

"We are communicating to everyone that everything will be fine. As we clarify on all the aspects, we will be able to regain trust and things will be normal soon," the official said.

Besides the Sebi rap, KSBL suffered a rating downgrade by ICRA. The official said the downgrade had nothing to do with the alleged misuse of client funds.

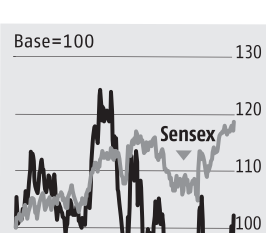
"Please note it is just a downgrade and not a default. The rating is for Karvy Stock Broking and its subsidiary companies. For subsidiary companies, the parent has to give a guarantee. But we are prohibited from giving a guarantee as it becomes a structured obligation under a new rule for brokers. Therefore, we haven't given any guarantee," the official said.

Industry players said several brokers are feeling the heat of Sebi's move to debar Karvy from using client funds — a practice that was fairly rampant in the broking industry.

THE COMPASS

IndusInd Bank may regain investor confidence

Stock gained over 22 per cent after Q2 results



Compiled by BS Research Bureau

HAMSINI KARTHIK

After being shunned by investors for long, IndusInd Bank appears to be on the path of regaining the lost trust. With gains of 22 per cent after its September quarter (Q2) results, investors seem willing to give some merit to the bank's guidance on asset quality. The quarter witnessed the bank's gross non-performing assets (NPA) rise to 2.15 per cent, while its slippages or loans turning bad more than doubled on a year-on-year basis to ₹1,102 crore. Not only was this the steepest increase in stress seen by the bank, that it also came at a time when management commentary was turning positive on asset quality spooked investors, prompting analysts at Bernstein to question the quality of the loan book.

Thankfully for the banking system as a whole, in the past month, no fresh trouble has emerged. Siddharth Purohit of SMC Capital says that this has helped sentiment turn in favour of the bank. "In the near term, the possibility of trouble from telecom sector exposure also seems low," he adds.

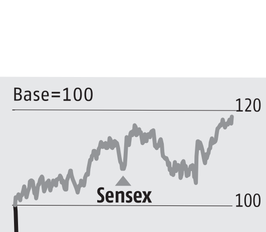
Analysts say investors are recognising the bank's efforts towards reducing its exposure to assets identified as potentially troublesome. Its watch list reducing from 1.9 per cent in the March'19 quarter to 1.1 per cent in Q2 is encouraging. Loans to the Indiabulls group — 0.72 per cent of IndusInd Bank's total loans — remaining standard assets for the entire banking system also allays fears that the bank's watch list may increase to 1.8 per cent in FY20.

However, while the asset quality pangs are settling down, whether the weak growth momentum turns into a headache for the bank in the next two quarters needs to be seen. In Q2, the bank's loan growth rate, excluding the microfinance loans, shrunk to 13 per cent year-on-year in Q2, making it two successive quarters of the metric falling from the peak of 30–35 per cent. While there is little evidence that growth is turning favourable for the banking sector, it assumes greater importance for IndusInd Bank as justifying valuations, which have already halved to 2.5x FY21 book from the historic 4x one-year forward estimates, may turn tough if it slips further on the growth aspect.

Analysts at Jefferies reduced their growth estimates for IndusInd by 5 per cent for FY20-FY22. The December quarter results will hence be important to see if the bank walks its path on asset quality and also help the Street gauge the growth prospects.

Q2 performance rebound a shot in the arm for Cipla

Promising domestic sales keep analysts positive



Compiled by BS Research Bureau

UJJVAL JAUHARI

The stock of pharma major Cipla has rebounded more than 18 per cent since its October lows. There were concerns earlier on the pace of domestic growth, given distribution and trade-related issues, subdued emerging market performance in the June quarter, and regulatory issues at its Goa plant.

The rebound in the domestic performance during the September quarter (Q2), however, has boosted the confidence of the Street. Analysts see more upside for the stock, as the outlook for US markets, too, looks promising. Macquarie recently maintained its outperform rating on Cipla, with a target price of ₹576. The stock remains its preferred pick in the large-cap pharma space.

A key trigger is growth in the Indian market, which contributes 40 per cent to the consolidated sales. Within this market, the respiratory segment, which accounts for a third of the consolidated figure, continues to generate good sales, recording growth of 16 per cent in Q2. Growing urology, cardiac, anti-diabetic, and women's health are the other key growth therapies for Cipla.

Given the strong performance of the branded business and expectations of growth rebounding in the trade generics segment by the third quarter, analysts now expect a steady domestic growth momentum in the second half of FY20. The company's domestic sales had declined 8 per cent year-on-year during the June quarter, but were up 9 per cent year-on-year in Q2.

While thyroid treatment generics in the US market were responsible for sales growth earlier, they are now facing competitive pressures, and analysts see growth momentum driven by other product launches. Cipla has guided for one high-value launch per quarter in the US starting Q4, and analysts estimate a $10-15-million opportunity for each drug, and profit margins of 70 per cent. Analysts at UBS say that Cipla's strategy of focusing on niche segments could work well and expect an improvement in gross margins over the next two years.

Cipla already has exclusivity in the supply of inputs for three generic products with Teva in FY21. In respiratory therapy, analysts expect the launch of generics of albuterol and Advair inhalers in FY21. Cipla received 12 observations at its Goa plant, which contributes 20-25 per cent to US sales. However, analysts say most of the products from this site have filings from alternative sites, and all the respiratory filings are from the Indore facility, which has US FDA clearance. Hence, analysts see a limited impact if the regulatory issues escalate.

Target prices of Macquarie, UBS, Morgan Stanley range from ₹550 to ₹578, indicating 14-20 per cent upside for the stock, which trades at ₹483.35.